



Macro Scope

24 - 30 May 2010

Weekly Economic and Strategic Review

Haluk Burumcekci (Managing Director)
Tel: +212 318 34 49
Email: haluk.burumcekci@fortis.com.tr

H. Erkin Isik, CFA (Manager)
Tel: +212 318 34 05
Email: erkin.isik@fortis.com.tr

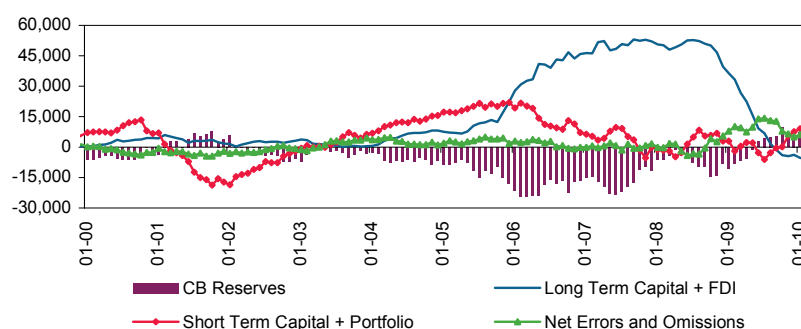
Nilufer Sezgin (Assistant Manager)
Tel: +212 318 37 90
Email: nilufer.s@fortis.com.tr

Email: research@fortis.com.tr
Tel: +212 272 79 98
Fax: +212 275 44 05

A New Friend or An Old Enemy?...

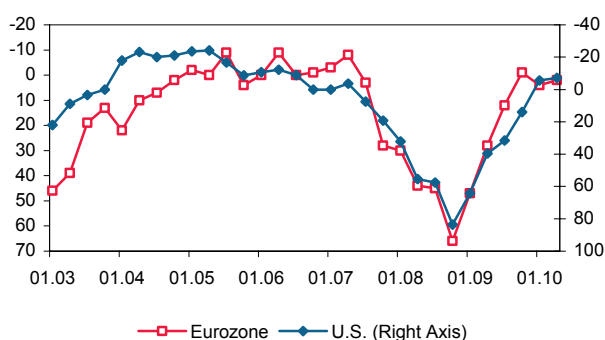
Turkey's pre-crisis, 12-month current account deficit (C/A) reached a historical high at \$49.1bn in August 2008. The economy then quickly drifted into recession and the C/A adjustment took approximately 13 months, with the deficit receding to \$12.5bn in October 2009. While the C/A deficit was again largely attributable to the foreign trade deficit, a surplus in the balance of services based on tourism revenues contributed to a drop in the overall need for external financing. With the economic recovery that has taken hold in the last five months, the current budget deficit has entered an upward trend and risen to \$21.9bn for the 12-month period. As can be expected, the main culprit behind this rapid deterioration is rising imports. Should we not see a slowdown in growth, the current budget deficit could hit \$35bn or higher. Both growth and C/A deficit consensus expectations in the market were low, and the \$20bn C/A deficit estimate made at the beginning of the current year was only marginally increased to \$28bn. There is no cause for concern even if the C/A deficit moves towards the level we forecast, as the Turkish economy would have no difficulty financing a deficit of this magnitude. That being said, the C/A deficit determines the speed limit of growth and its financing structure is vulnerable to any sudden halt in such economic trends – meaning that we should not let our guard down. In the last few months, short-term capital and portfolio movements have comprised a bigger share of the financing of the C/A deficit, and this is not a good sign. While the total external financing need in the last 12-month period stemmed from the \$21.9bn C/A deficit and an additional \$5.6bn long-term credit repayment, \$19.8bn of this shortfall was financed by short-term capital and portfolio flows, \$1.7bn by net errors and omissions item and the remaining \$6.1bn by the Central Bank reserves. Even when there was the high deficit of \$49bn in 2008, long-term credit and foreign direct investment alone were able to provide \$52bn in financing. The global crisis broke out with a credit crunch and problems with financial intermediation and has hit the long-term credit movements the hardest.

Current Account Financing (Main Items, Last 12 months cumulative, mn US\$)



Although it seems the effects of the crisis are now behind us, current data indicates that Turkey's net repayer position in terms of long-term foreign credit had not changed. The private sector's external debt rollover ratio for long-term loans stood at 72% throughout 2009 but fell to 65% in the January to March period. In the banking sector, the 82% long-term debt rollover ratio in 2009 receded to a mere 54% in the January to March period. After the noticeable tightening of conditions for extending credit in 2008, it is surprising that while as of the first quarter of 2009 such conditions in the U.S. and the eurozone were relaxed and returned to arguably normal levels, debt rollover ratios remained low. Certain factors played a key role in this situation, however. Amendments to clauses on the use of foreign exchange and foreign exchange indexed loans as per Decree 32 on Protection of the Value of the Turkish Currency made it easier for domestic banks to extend FX loans as of June 16, 2009. (Please See Box) Thereafter, companies used fewer foreign loans extended by banks overseas in favour of using domestic loans extended by domestic banks. The Central Bank reports noted that following the adjustments to private sector long-term debt rollover ratios that took into account this impact, the ratio was over 100%. Before the abovementioned amendment, banks were able to extend FX loans only to exporters or a very limited number of customers who have FX revenues or operate in sectors specified by the Turkish Treasury. Firms incorporated in Turkey (with no FX revenues) and in need of FX loans for any operations other than those allowed for in the Decree had been using either FX-indexed loans from banks operating in Turkey or FX loans from foreign banks or the foreign branches of banks established in Turkey. With this amendment, statistical data on the total amount of foreign debt – and thus Turkey's creditworthiness – will be improved as loans obtained by Turkish residents from foreign branches of Turkish banks, which are actually domestic debt, are removed from the total figure for Turkey's foreign debt. And indeed, since the amendments came into effect, FX loans obtained from the foreign branches of domestic banks have started to decline, with a corresponding increase in the outstanding amount of the same kind of loans obtained from their domestic branches. Thanks to these amendments, the stock of FX loans obtained from foreign branches receded to \$34.2bn (from \$40bn) by the end of March. In contrast, the stock of FX loans extended by domestic banks in Turkey rose from \$25bn to \$35bn in the same period.

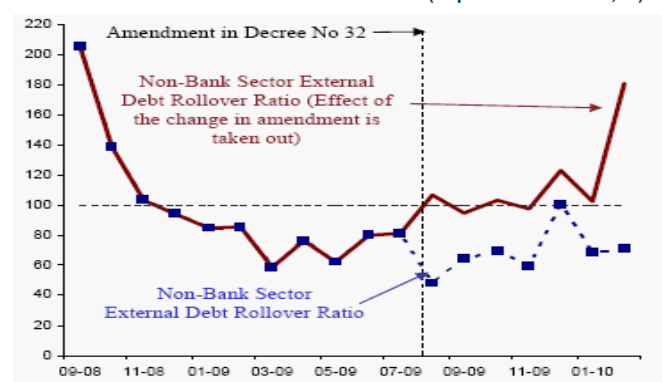
Expectations For Credit Standards in the U.S. And Eurozone



(*) Net Percentage of Domestic Respondents Tightening Standards for C&I Loans .

Source: CBT, Fortis Economic Research & Strategy

Non-Bank Sector External Debt Rollover Ratio (Sep 2008 - Feb 2010, %)



One could also expect this change of location in the source of loans to also be reflected in the volume of domestic loans. Given that foreign branches are excluded in the monitoring and analysis of domestic loan growth, the shifting of the source could exaggerate the actual increase in the total amount of domestic credit. This could explain the Central Bank's statement in its Inflation Report that "in the current situation, the pace of recovery in the credit market is thought to be at a level that will not cause any inflationist pressure nor any risk to financial stability". It could also explain the bank's message that it would not rush to lift the measures taken during the crisis to protect the credit market (three-month repos

and a reduction in the Turkish lira reserve requirement ratios) despite a more than 20% annual increase and a 0.7% weekly increase implying a 40% growth trend in recent loan figures of the banking system.

As stated in our FX Risk of Corporates Report issued this week, these developments did not bring any changes in corporates' F/X open position – despite the fact that in the second half of 2009 and in the first quarter of 2010, corporates' F/X open positions stemming from foreign transactions decreased by \$7bn, while domestic F/X open positions increased by \$11.2bn. This means that while previously corporates' F/X open positions would be fully accounted for by the difference between their overseas assets and liabilities, at the end of the first quarter \$11.6bn of the \$84bn open position was accounted for by their domestic assets and liabilities. The continuation of this trend will be contingent upon the course of the decline in the extension of foreign exchange loans via overseas branches.

In conclusion, we contend that continued growth in the Turkish economy will bring about a re-widening of the current budget deficit. And while we do not foresee any problems in Turkey obtaining the necessary financing, the recent reduction in the quality of the financing structure (the rising share of short-term capital movements) should be closely monitored. Several factors indicate that the situation surrounding long-term loans – the most important financing item – is not as bad as it seems. But without any ramp up in long-term financing, the strengthening of fixed investments and overall growth trend will be limited.

Amendment to Decree Number 32 Regarding the Protection of the Value of the Turkish Currency

With the publication of Decree Number 2009-15082 in the Official Gazette No. 27260, dated 16 June 2009, the articles related to foreign exchange (FX) loans in "Decree Number 32 Regarding the Protection of the Value of the Turkish Currency" have been amended.

Accordingly;

- 1) Consumers have been prevented from taking FX risk by borrowing FX loans or FX-indexed loans, by prohibiting them from borrow such loans from both foreign banks and domestic banks.
- 2) Banks are allowed to extend FX credits to firms incorporated in Turkey which have no FX income but favor FX loans
 - a) With the condition of at least 1 year maturity and a minimum amount of 5 million USD,
 - b) Without any condition on maturity or amount, if collateral is in the form of foreign currency deposits in the domestic branches of banks or foreign currency denominated bonds which are issued or guaranteed by central governments or the central banks of OECD countries.

Economic and Political Agenda

- This week at home, capacity use and real sector confidence index on Monday and CBT's Financial Stability Report on Wednesday will be important. Glancing at external arena, in the US, new home and existing home sales, Q1 PCE and GDP Michigan sentiment index and durable orders are going to be eyed closely.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Capacity Use, May	%	May 24 rd , 13:30 GMT	(72.6)
High	Real Sec. Confid. Index, May		May 24 rd , 13:30 GMT	-
Medium	Financial Stability Report		May 26 rd	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	U.S.	Existing Home Sales, Apr.	mn	May 24 rd , 14:00 GMT	5.59
Medium	U.S.	C. Shiller Hous. Price Ind., Mar.	-	May 25 rd , 13:00 GMT	1.9
Medium	U.S.	Cons. Conf. Index, May.	-	May 25 rd , 14:00 GMT	59.1
Medium	U.S.	Durable Ord., Apr.	% m/m	May 26 rd , 12:30 GMT	0.9
High	U.S.	New Home Sales, Apr.	mn	May 26 rd , 14:00 GMT	0.42
High	U.S.	Core PCE, Q1	% quart.	May 27 rd , 12:30 GMT	0.6
High	U.S.	GDP (preliminary), Q1	% q/q	May 27 rd , 12:30 GMT	3.2
High	U.S.	Core PCE, Apr.	% m/m	May 28 rd , 12:30 GMT	0.1
High	U.S.	Chicago PMI, May.	-	May 28 rd , 13:45 GMT	63.0
High	U.S.	Michigan Sent. Ind., May.	-	May 28 rd , 13:55 GMT	73.5

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2009-2012

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	954.0	1,090.1	1,197.4	1,310.7
GDP (US\$ - bn) (*)	616.6	717.1	776.7	834.9
GDP Growth (y/y % chg) (*)	-4.7	6.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	5.0	5.0
CPI (y/y % chg)	6.5	8.0	6.0	5.5
Trade Balance (US\$ - bn)	-38.6	-61.2	-69.8	-70.4
Exports (FOB, excl. luggage trade)	102.2	104.9	122.9	142.7
Imports (CIF, incl. gold)	140.8	166.1	192.7	213.0
Current Account Balance (US\$ - bn)	-13.8	-34.3	-39.4	-36.9
Current Account Balance / GDP (%)	-2.2	-4.8	-5.1	-4.4

(*) 2010 values are our forecasts

Financial Indicators Forecasts

	May 14 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5727	1.5500	1.5200	1.5200	1.5300	1.5200	1.5600
EUR/TRY	1.9439	1.8800	1.9300	1.9800	2.0400	1.9800	2.1500
FX Basket	3.5166	3.4300	3.4500	3.5000	3.5700	3.5000	3.7100
EUR/US\$	1.2360	1.2100	1.2700	1.3000	1.3333	1.3000	1.3800
Policy Rate	7.00%	7.00%	7.00%	8.00%	10.00%	8.50%	10.00%
Benchmark Bond	9.30%	9.50%	10.40%	10.90%	11.50%	11.00%	11.50%

Fortis Bank SA/NV Montagne du Parc 3 B-1000 Brussels Belgium Tel: +32 2 565 11 11	Fortis Bank Austria Euro Plaza/D Wienerbergstrasse 41 1120 Vienna Austria Tel: +43 1 81 10 43 81 85	Fortis Bank Czech Republic Myslbek Building Ovocny Trh 8 117 19 Prague 1 Czech Republic Tel: +420 225 43 60 10	Fortis Bank Denmark Gothersgade 49 3. 1123 Copenhagen Denmark Tel: +45 32 71 19 09
Fortis Bank, Succursale en France 30, quai de Dion Bouton F-92824 Puteaux Cedex France Tel: +33 1 55 67 72 00	Fortis Bank Germany Cäcilienkloster 8 50676 Cologne Germany Tel: +49 221 1611-0	Fortis Bank Greece Sygrou Ave 166 17671 Athens Greece Tel: +30 21 09 54 43 70	Fortis Bank Hong Kong 27/F, Fortis Bank Tower 77-79 Gloucester Road Hong Kong Tel: +852 28 23 04 56
Fortis Bank Hungary Deak Ferenc 15 1052 Budapest Hungary Tel: +36 14 83 81 09	Fortis Bank Italy Via Comaggia 10 I-20123 Milano Italy Tel: +39 02 57 53 24 61	BGL 50, avenue J.F. Kennedy L-2951 Luxembourg Luxembourg Tel: +352 42 421	Fortis Bank Norway Haakon VII's gate 10 0161 Oslo Norway Tel: +47 23 11 49 50
Fortis Bank Polska S.A. P.O. Box 15 02-676 Warszawa Poland Tel: +48 22 566 90 00	Fortis Bank Portugal Rua Alexandre Herculano 50-6 Andar 1250-011 Lisboa Portugal Tel: +351 213 13 93 16	Fortis Bank SA/NV, Singapore Branch 63 Market Street #21-01 Singapore 048942 Tel: +65 65 38 03 90	Fortis Bank S.A., Sucursal en España Serrano 73 28006 Madrid Spain Tel: +34 91 436 56 00
Fortis Bank Romania Tipografilor 11-15 013714 Bucharest Romania Tel: +40 21 401 17 02	Fortis Bank Sweden Birger Jarlgatan 25 10396 Stockholm Sweden Tel: +46 8 505 375 59	Fortis Bank Switzerland Rennweg 57 8021 Zurich Switzerland Tel: +41 58 322 09 70	Fortis Bank Turkey Yildiz Posta Caddesi No: 54 Gayrettepe 34353 Istanbul Turkey Tel: +90 212 274 42 80
Fortis Bank SA/NV, UK Branch 5 Aldermanbury Square EC2V 7HR London United Kingdom Tel: +44 20 32 96 80 00	Fortis Bank USA 520 Madison Avenue, 3rd Floor New York, NY 10022 United States Tel: +1 212 418 87 00		

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